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In the Supreme Court of the United States

OCTOBER TERM, 1941.

No. ~~1017.~~ 41

GUY T. HELVERING,
Commissioner of Internal Revenue,
Petitioner,

vs.

THE STRONG MANUFACTURING COMPANY,
Respondent.

BRIEF OF THE STRONG MANUFACTURING COMPANY IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT.

ARTHUR MORGAN,
RAYMOND S. POWERS,
704-5 Union National Bank Bldg.,
Youngstown, Ohio,
Attorneys for The Strong Manufacturing Company, Respondent.

RAYMOND S. POWERS,
Of Counsel.

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vs.

THE STRONG MANUFACTURING COMPANY,
Respondent.

BRIEF OF THE STRONG MANUFACTURING COMPANY IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI.

I. INTRODUCTORY STATEMENT.

Respondent, The Strong Manufacturing Company, opposes the petition for certiorari filed in this Court by the Solicitor General on behalf of Guy T. Helvering, Commissioner of Internal Revenue, Petitioner, to review the judgment of the United States Circuit Court of Appeals for the Sixth Circuit entered in the above styled case December 9, 1941. Respondent, The Strong Manufacturing Company, will hereinafter be referred to as "Taxpayer." The Commissioner of Internal Revenue, Petitioner, will hereinafter be referred to as "the Commissioner."

II. OPINIONS OF UNITED STATES CIRCUIT COURT OF APPEALS AND BOARD OF TAX APPEALS.

The findings of fact, the majority opinion holding for Taxpayer and the minority opinion of the Board of Tax Appeals are reported in 41 B. T. A. 1273, and are also found in the Record, 14-22. The unanimous opinion of the Cir-

cuit Court of Appeals for the Sixth Circuit, affirming the decision of the United States Board of Tax Appeals for Taxpayer, is reported in 124 F. (2d) 360 and will also be found in the Record 134-141.

III. QUESTION INVOLVED.

Whether the United States Board of Tax Appeals and the United States Circuit Court of Appeals were correct in holding that Taxpayer was entitled to a credit on its 1936 surtax on undistributed profits under Section 26(c)(2) of the 1936 Revenue Act based on the irrevocable setting aside and payment of $46,500.00 of Taxpayer's 1936 profits on a note and mortgage executed April 15, 1932, which amount was less than the 40 per cent of its 1936 profits Taxpayer was expressly required, thereunder, to apply on said obligation.

IV. STATUTES AND REGULATIONS INVOLVED WILL BE FOUND IN THE APPENDIX ATTACHED TO THIS BRIEF.

V. INACCURACY IN COMMISSIONER'S STATEMENT OF FACTS CORRECTED.

The facts in this case as set forth in the Commissioner's "Statement" (Pet. for Cert., pp. 2-4) are substantially accurate according to Taxpayer's views, with the exception that the Commissioner interpreted Taxpayer's obligation to require only the excess over the specific installment due in each calendar year to be paid out of 40 per cent of such year's profits. Pet. for Cert., p. 3.

The Board of Tax Appeals by its findings of fact and opinion held *contra* to the interpretation of Taxpayer's note and mortgage contended for by the Commissioner, 41 B. T. A. 1273, R. 134-141. The Commissioner assigned

no error on this ground in the Circuit Court of Appeals and the Commissioner's argument on this point was overruled by the unanimous opinion of that court. R. 23-27, 134-141. 124 F. (2d) 360, 365. The Commissioner's interpretation of Taxpayer's note and mortgage, that only the excess above the specified installments due in 1936 were required to be paid out of 40 per cent of Taxpayer's 1936 earnings, is erroneous.

VI. POINTS ON WHICH TAXPAYER RELIES IN OPPOSITION TO THE COMMISSIONER'S PETITION FOR CERTIORARI.

(1) Upon the facts there is no conflict between the decisions of *Antietam Hotel Corp. v. Commissioner* (4th C. C. A., Nov. 10, 1941), 123 F. (2d) Sec. 274 and in *Commissioner v. The Strong Manufacturing Co.* (6th C. C. A., Dec. 9, 1941), 124 F. (2d) 360.

(2) The Federal Statute involved has been repealed and no like statute is now in effect, and, in any event, only an issue as to the interpretation of a contract unique in this case is presented.

(3) This case does not involve any important or far reaching issue of Federal law which this Court should determine.

(4) The Decisions of the United States Circuit Court of Appeals and of the United States Board of Tax Appeals are correct.

VII. REASONS WHY THIS COURT SHOULD NOT GRANT COMMISSIONER'S PETITION FOR CERTIORARI.

1. THE CONFLICT BETWEEN ANTIETAM HOTEL CORP. v. COMMISSIONER, 123 F. (2d) 274 AND COMMISSIONER v. THE STRONG MANUFACTURING CO., 124 F. (2d) 360, IF ANY, IS ONE OF FACT NOT OF LAW.

Taxpayer's note and mortgage in the case at bar, in terms, required it to "apply" 40 per cent of its annual net earnings in payment. Taxpayer's obligation to "apply" its profits connoted a requirement to irrevocably set aside for payment as well as pay such percentage of its net earnings on its note and mortgage. *Commissioner v. Strong*, 124 F. (2d) 360, 363, 365. Further, in the case at bar, the payment out of 40 per cent of Taxpayer's profits up to the balance due on its obligation was made by Taxpayer within the taxable year of 1936 (R. 44-45) constituting a definite act recognizing its creditor's equitable lien on such profits and a divesting of Taxpayer's control over them.

In the respect that Taxpayer's note and mortgage required the setting aside of profits during 1936 coupled with Taxpayer's definitive act of recognition of the equitable lien on these profits by paying them over to its creditor there is evidenced a complete compliance with Section 26(c)(2) of the 1936 Revenue Act as interpreted by the Court in *Antietam Hotel Corp. v. Commissioner*, 123 F. (2d) 274.

The contract in the *Antietam Hotel Corp.* case, *supra*, was essentially different than the note and mortgage in the case at bar. In the *Antietam* case, *supra*, the controlling provisions of the bond indenture did not require the debtor corporation to "pay" 60 per cent of its 1936 profits until March 20, 1942 and was wholly silent as to any obligation,—as is implicit in the use of the term "apply" in the note and mortgage in the case at bar,—to ir-

revocably set aside such profits as they accrued. Further in the *Antietam* case the debtor failed to segregate the profits applicable to the payment of the bonds prior to the end of 1936 or divest its control over them, as Taxpayer did in the *Strong* case, by paying over the obligated profits to the debtor in the taxable year. Because the facts in the case at bar do conform to the rule laid down in the *Antietam* case, the application of the rule in the *Antietam Hotel Corp.* case would not call for a different determination of the instant case. Contrary to the Commissioner's assertion, there is no discoverable conflict between the rules laid down in each case when applied to the facts in the case at bar. The Board of Tax Appeals in its Memorandum Decision handed down October 23, 1940, in the case of *Antietam Hotel Corporation vs. Commissioner*, C. C. H. B. T. A. Dec., Sec. 11357-A (affirmed by the Circuit Court of Appeals for the Fourth Circuit, 123 F. (2d) 274) distinguished that case from the *Strong Manufacturing* case, on the facts, as follows:

> "We have considered the general question involved in the instant proceedings in recent opinions. In *Strong Mfg. Co.*, 41 B. T. A. 1273, wherein the taxpayer was granted a credit, it appeared that the company anticipated its income for the taxable year and actually did make the payment within the taxable year there in question. Therein the facts differ materially from our instant case."

Commissioner's petition for certiorari should be denied since the conflict between the decisions in the *Antietam Hotel Corporation* case, *supra*, and *The Strong Manufacturing Company* case, *supra*, is one of facts and not of law. *Sanchez v. Borras* (1931) 283 U. S. 798, 51 S. Ct. 490, 75 L. Ed. 1421; *Wisconsin Elect. Co. v. Dumore Co.* (1931) 282 U. S. 813, 51 S. Ct. 214, 75 L. Ed. 728; *Layne and Bowler Corporation v. Western Well Works* (1923) 261 U. S. 387, 43 S. Ct. 422, 67 L. Ed. 712; *Keller v. Adams-Campbell Co.* (1924) 264 U. S. 314, 44 S. Ct. 356, 68 L. Ed. 705.

2. SECTION 26(c)(2) OF THE 1936 REVENUE ACT HAS BEEN REPEALED AND NO LIKE STATUTE IS NOW IN EFFECT OR LIKELY TO BE ENACTED.

There is no existing statute which needs to be interpreted or a similar statute to which such an interpretation might be applied by analogy. Section 26(c)(2) has been repealed after several amendments still proved the whole theory of the original law either impracticable or obsolete. 3 P.-H. Fed. Tax Serv. (1942) 50,241. Hence no great public interest requires this Court to take jurisdiction of this case.

3. THIS CASE DOES NOT INVOLVE ANY IMPORTANT OR FAR REACHING PRINCIPLE OF FEDERAL LAW WHICH THIS COURT SHOULD DETERMINE.

The case at bar presents, Taxpayer believes, only an issue as to the interpretation of apt language of a contract. The United States Board of Tax Appeals, by majority opinion, and the Circuit Court of Appeals for the Sixth Circuit, by unanimous affirmance, held Taxpayer's contract required the setting aside of a certain percentage of taxpayer's profits for the payment of a debt within the provisions of Sec. 26(c)(2) of the Internal Revenue Act for 1936. The Commissioner does not assert that the provision, here in issue, is typical of any contract involved in any other case under Section 26(c)(2). Moreover a diligent search by counsel does not disclose any case noted in the digests involving a contract of similar language. The Commissioner specifically admits that the contract in the case of *Guy T. Helvering, Commissioner v. Ohio Leather Co.*, No. 1016 pending on the docket of this Court by petition for certiorari, is not identical with the contract in the case at bar. Commissioner's Pet. for Cert., p. 4. The contract involved in the case of *Guy T. Helvering, Commissioner v. Warren Tool Company*, No. 1018 pending on the docket of this Court on petition for certiorari, is substantially similar to that involved in the *Ohio Leather*

Company case, *supra*, so that the Commissioner must concede that the contract in the *Warren Tool Company* case also differs from the contract in the case at bar. There is, therefore, involved in this case only a question of the interpretation of a unique contract which the Commissioner seeks to have redetermined after adverse decisions in both tribunals below. There is no issue present, as Taxpayer views it, of the interpretation of Section 26(c)(2). Taxpayer's Brief, Sec. VII, 1, *ante*. Moreover, the Commissioner in his brief opposing certiorari in the case of *Moloney Electric Company v. Commissioner*, Nos. 659 and 660 on this docket (certiorari denied Nov. 10, 1941, rehearing denied Jan. 12, 1942) asserted that the interpretation of Section 26(c)(2) of the 1936 Revenue Act, now repealed, was not necessary to the determination of future disputes. The Commissioner in his brief opposing certiorari in the *Moloney* case, *supra*, said in part:

> "The decision of the court below is correct in both cases and there is no conflict or other reason for review. Contrary to petitioner's assertion (Pet. 6), the cases do not present any important issue of Federal law which this Court should determine. They merely involve claims to credits in the computation of the surtax imposed by the Revenue Act of 1936 upon undistributed corporate profits, and their outcome turns, not on any new or far-reaching principle of law, but on the particular facts."

This Court had before it as a ground for granting reconsideration of its denial of certiorari in the *Moloney Electric Company* case, *supra*, the opinion of the Circuit Court of Appeals in the case at bar. Since the facts in the *Moloney Electric Company* case, *supra*, and in the *Antietam Hotel Corporation* cases are substantially alike and the decisions in both cases are adverse to the allowance of the claimed credit, the denial of certiorari in the *Moloney Electric Company* case is offered as specific authority against allowance of the writ in this case.

Commissioner's petition for certiorari should not be granted in this case since it will have no higher result than to allow him a third hearing on an issue determinative only of the instant controversy. *National Labor Relations Board v. Waterman S. S. Corp.* (1940) 309 U. S. 206, 60 S. Ct. 493, 84 L. Ed. 704; *Crowell v. Benson* (1932) 285 U. S. 22, 65, 52 S. Ct. 285, 76 L. Ed. 598; *United States v. Johnston* (1925) 268 U. S. 220, 45 S. Ct. 496, 69 L. Ed. 925; *Southern Power Co. v. North Carolina Service Co.* (1924) 263 U. S. 508, 44 S. Ct. 164, 68 L. Ed. 413; *Magnum Import Co. v. Coty* (1923) 262 U. S. 159, 163, 43 S. Ct. 531, 67 L. Ed. 922.

4. THE DECISIONS OF THE UNITED STATES CIRCUIT COURT OF APPEALS AND OF THE UNITED STATES BOARD OF TAX APPEALS ARE CORRECT.

It was established in the case at bar, without dispute by the Commissioner, that under his interpretation of Section 26(c)(2) all corporations who based their computation of profits in part upon an inventory would be unable to obtain a credit under that statute, for the reason that a physical inventory could not be taken until after the close of the calendar year. (R. 52-57, 134, 137.) Only financial institutions could qualify under the provisions of 26(c)(2) of the 1936 Revenue Act, and they were specifically exempt from the 1936 surtax on undistributed profits. U. S. Statutes at Large, 74th Congress, c. 690, Title I, Section 104(b), 49 Stat. 1677. The Court below held that no such construction of the statute was justified in view of the history of Section 26(c)(2) and the applicable rules of interpretation set forth in the decisions of this Court which it cited. *Commissioner v. The Strong Manufacturing Co.*, 124 F. (2d) 360, 363-364. This Court has held that Section 26(c) comprehends a computation based on an entire year's corporate profits. *Helvering v. Northwestern Steel Mills* (1940) 311 U. S. 46, 61 S. Ct. 109. Since no such computation could be made until after the close of the year, that undoubtedly correct conclusion is additional support for

the decisions of the United States Board of Tax Appeals and of the Circuit Court of Appeals below in the case at bar. The decision of the United States Circuit Court of Appeals for the Sixth Circuit and of the United States Board of Tax Appeals in the case at bar are supported by such sound reasons and in accord with principles the United States Supreme Court has so many times affirmed that it should not take jurisdiction on the Commissioner's petition for certiorari.

VIII. CONCLUSION.

In conclusion, Taxpayer submits, that the conflict claimed by the Commissioner to exist between the decisions of *Antietam Hotel Corporation v. Commissioner*, 123 F. (2d) 274 and *Commissioner v. The Strong Manufacturing Company*, 124 F. (2d) 360, is solely one of fact. Section 26(c)(2) of the 1936 Internal Revenue Act, here involved, has been repealed and no like statute is now in effect demanding an interpretation by this Court. Moreover, this case raises only an issue as to the interpretation of Taxpayer's contract and no purpose can be served if this Court takes jurisdiction except to grant the Commissioner a third hearing after an adverse result in both tribunals below, which decisions are sound and in accord with principles repeatedly affirmed by this Court. It is, therefore, urged that this Court should not grant the Commissioner's petition for certiorari in this cause.

Respectfully submitted,

ARTHUR MORGAN,
RAYMOND S. POWERS,
704-5 Union National Bank Bldg.,
Youngstown, Ohio,
Attorneys for The Strong Manufacturing Company, Respondent.

RAYMOND S. POWERS,
Of Counsel.

March 27, 1942.

APPENDIX.

Revenue Act of 1936, Statutes at Large, c. 690; 49 Stat. 1648:

SEC. 14. SURTAX ON UNDISTRIBUTED PROFITS.

(a) *Definitions.*—As used in this title—(1) The term "adjusted net income" means the net income minus the sum of—

(A) The Normal tax imposed by section 13.

* * * * *

(2) The term "undistributed net income" means the adjusted net income minus the sum of the dividends paid credit provided in section 27 and the credit provided in section 26(c), relating to contracts restricting dividends.

(b) *Imposition of Tax.*—There shall be levied, collected, and paid for each taxable year upon the net income of every corporation a surtax equal to the sum of the following, subject to the application of the specific credit as provided in subsection (c):

7 per centum of the portion of the undistributed net income which is not in excess of 10 per centum of the adjusted net income.

12 per centum of the portion of the undistributed net income which is in excess of 10 per centum and not in excess of 20 per centum of the adjusted net income.

* * * * *

SEC. 26. CREDITS OF CORPORATIONS.

In the case of a corporation the following credits shall be allowed to the extent provided in the various sections imposing tax—

* * * * *

(c) *Contracts Restricting Payment of Dividends.*—

* * * * *

(2) *Disposition of Profits of Taxable Year.*—An amount equal to the portion of the earnings and profits of the taxable year which is required (by a provision of a written contract executed by the corporation prior

to May 1, 1936, which provision expressly deals with the disposition of earnings and profits of the taxable year) to be paid within the taxable year in discharge of a debt, or to be irrevocably set aside within the taxable year for the discharge of a debt; to the extent that such amount has been so paid or set aside. For the purposes of this paragraph, a requirement to pay or set aside an amount equal to a percentage of earnings and profits shall be considered a requirement to pay or set aside such percentage of earnings and profits. As used in this paragraph, the word "debt" does not include a debt incurred after April 30, 1936.

* * * * *

Treasury Regulations 94, promulgated under the Revenue Act of 1936:

ART. 26-2. *Credit in connection with contracts restricting payment of dividends.*—

(a) The credit provided in section 26 (c) with respect to contracts restricting the payment of dividends is not available under every contract which might operate to restrict the payment of dividends, but only with respect to those provisions of written contracts executed by the corporation prior to May 1, 1936, which satisfy the conditions prescribed in the Act. The charter of a corporation does not constitute a written contract executed by the corporation within the meaning of Section 26 (c). The provisions recognized by the Act are of two general types, as follows:

(1) Those which come within section 26 (c) (1), in that they prohibit or limit the payment of dividends during the taxable year; and

(2) Those which come within section 26 (c) (2), in that they require the payment, or irrevocable setting aside, within the taxable year, of a specified portion of the earnings or profits of the taxable year for the discharge of a debt incurred on or before April 30, 1936.

* * * * *

(c) *Disposition of profits of taxable year.*—Under the provisions of section 26 (c) (2), a corporation is allowed a credit in an amount equal to that portion of

the earnings and profits of the taxable year which, by the terms of a written contract executed by the corporation prior to May 1, 1936, and expressly dealing with the disposition of the earnings and profits of the taxable year, it is required within the taxable year to pay in, or irrevocably to set aside for, the discharge of a debt incurred on or before April 30, 1936. The credit is limited to that amount which is actually so paid or irrevocably set aside during the taxable year pursuant to the requirements of such a contract.

Only a contractual provision which expressly deals with the disposition of the earnings and profits of the taxable year shall be recognized as a basis for the credit provided in section 26 (c) (2). A corporation having outstanding bonds is not entitled to a credit under a provision merely requiring it, for example, (1) to retire annually a certain percentage or amount of such bonds, (2) to maintain a sinking fund sufficient to retire all or a certain percentage of such bonds by maturity, (3) to pay into a sinking fund for the retirement of such bonds a specified amount per thousand feet of timber cut or per ton of coal mined, or (4) to pay into a sinking fund for the retirement of such funds an amount equal to a certain percentage of gross sales or gross income. Such provisions do not expressly deal with the disposition of earnings and profits of the taxable year merely because it deals with such earnings and profits in terms of "net income," "net earnings," or "net profits."

* * * * *